Council for Affordable and Rural Housing
Serving the Affordable Housing Needs of Rural America

April 13, 2016

Administrator Tony Hernandez
Rural Housing Service
United States Department of Agriculture
Room 5014, Mailstop 0701
1400 Independence Avenue, S.W.
Washington, DC 20250

Dear Administrator Hernandez:

We write you to further discuss improving the Section 538 Guaranteed Rural Rental Housing Program and further advancing the productive public/private partnership that is the 538 program. The President's Fiscal Year (FY) 2017 budget contains renewed focus on the Section 538 program, providing an increase in authority to $230 million in 538 loans. We believe the need and demand exists to meet this goal, but we believe further 538 tools will be needed. Specifically, we request that the Agency facilitate four changes to the program.

First, allow single continuous guarantees for construction and permanent loans or "Option Three" Section 538 transactions to benefit from the 70 percent loan-to-cost ratio that exists for other types of Section 538 loans. Second, allow 538 to be used for straight refinancing. Third, reduce the Annual Fee to make loans more affordable. Fourth, eliminate the Notice of Funds Availability or NOFA.

We previously worked together to help increase the loan to cost ratio on Ginnie Mae supported 538 loans to 70 percent. This higher loan-to-cost ratio is opening up preservation opportunities for many of our members. As we understand it, this increased ratio has been applied to the guarantee of permanent loans or "Option One" transactions as well as advances during construction and (when eligible) the permanent loan or "Option Two" transactions. Section 538 regulations at 7 C.F.R. Section 3565.52(c) provides for three types of 538 guarantees. The Agency limits this program to low loan-to-cost ratios, as defined by the Agency in the 538 Notices. We request that the Agency use the same 70 percent loan-to-cost ratio, which is a low ratio for **all** option loans. We understand that the stringent Section 538 program underwriting has resulted in no material increased default rate under Option 3 versus the other options. Loan to cost limits in other programs for similarly sized affordable housing loans range from 80 to 90 percent. See HUD Mortgagee Letter 2014-18.

Refinancing is an important use for the 538 program, helping to manage debt loan and interest rate terms through the marketplace. There is a substantial need for credit in rural areas. The multifamily property industry continues to struggle with credit availability in rural areas, even as many urban areas have access to many affordable housing and market rate loan product. The 538 program is built to address this credit issue.

Section 538 program regulations at 7 CFR 3565.206 limit Section 538 loan proceeds to refinancing outstanding debt, except where the refinancing is in the government's interest or furthers the objectives of the program. Refinancing existing 538 loans, 515 loans that are allowed to prepay, or existing affordable housing loans to more reasonable terms to preserve affordability all would bring much needed credit to rural areas, would further the government's interests as well as further the objectives of the program.

The Agency should reduce the Annual Fee. The costs associated with the 538 program have risen over time. Reducing the fee helps make the program more affordable. In the early years of the program, 538 loans often came with interest credit subsidy to offset interest costs, but that subsidy was eliminated. Later, to save money, the government proposed eliminating the 538 program, but as a result of work by the industry and agency, fees were instituted and the program became self-funding. Indeed, the program funds itself as it makes new loans and collects new fees, far more than is needed to offset risk in the 538 program. Looking at the subsidy rates in the FY2017 President's budget, it appears that the net receipts to the government are climbing. This, in essence, over-secures this program, far more than originally intended. HUD recently cut the multifamily mortgage insurance premium (MIP) rates to help preserve and increase the amount of affordable, quality rental housing across the country. See *Federal Register*, page 4926 (January 28, 2016). The MIP is the equivalent to the Annual Fee in the 538 program. Furthermore, Affordable Housing, or Green and Energy Efficient Housing, will see MIP rates of 25 basis points, and FHA-insured affordable housing will have 35 basis point MIPs. By contrast, the 538 Annual Fee is still 50 basis points, and thus is not as cost efficient in areas where credit beyond the 538 program is available.

Finally, we would like to reiterate our long-standing request to eliminate the Notice of Funds Availability (NOFA) or Notice of Solicitation of Applications (NOSA) process from the program. This loan guarantee program does not work well with a NOFA or NOSA process. Originations can move much more efficiently throughout each calendar year without the gaps created by waiting for the NOFA or NOSA. We appreciate that RD has used the NOSA to help address the issue, but elimination of the NOFA process altogether would be most efficient. As noted above, the 538 program no longer relies on federal appropriations. As such, having a notice of funding availability is inapplicable in all respects.

We appreciate your continued, progressive assessment of the 538 program and we hope to hear soon about the above requests.

Sincerely,

Colleen M. Fisher

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Executive Director